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No. 857

In the Supreme Court of the United States

October Term, 1940

JAY O. HORMEL, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 257

JAY C. HORMEL, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The majority (R. 14–19) and minority (R. 19–22) opinions in the Board of Tax Appeals are reported in 39 B. T. A. 244. The opinion of the Circuit Court of Appeals (R. 42–50) is reported in 111 F. (2d) 1.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 25, 1940 (R. 50–51). The petition for a writ of certiorari was filed July 19, 1940, and was granted October 14, 1940. The jurisdiction of this Court rests upon Section 240

(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the Circuit Court of Appeals had authority to consider the applicability of Section 22 (a) of the Revenue Act of 1934 in the circumstances of this case.

2. If so, whether the grantor was taxable under Section 22 (a) on the trust income here involved.

3. In the alternative, whether this income was taxable to the grantor under Section 167 of the Revenue Act of 1934.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and regulations are set forth in Appendix A, *infra,* pp. 28–37.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 14–15), and supplemented by other stipulated facts (R. 28–37), are as follows:

Taxpayer is an officer of George A. Hormel & Company, a Delaware corporation of Austin, Minnesota (R. 29). On July 16, 1934, he created three trusts designated as Jay C. Hormel trusts Nos. 3, 4, and 5, naming himself and one Park Dougherty as joint trustees and conveying to each trust 2,000 shares of common stock of George A. Hormel & Company (R. 15, 29). Each trust instrument recited that the trust was created for the benefit of the taxpayer and his wife as guardian of one

of their minor sons. Dividends not in excess of $2,000 per year in the case of each trust were to be paid to the taxpayer's wife, in her capacity as guardian, "for the use and benefit" of the son; excess dividends were to be paid to the grantor, as co-beneficiary (R. 15, 30, 33, 35). No title to the trust estate or any dividends from it were to vest in the guardian or child, nor were they given any power to dispose of any interest in it prior to actual payment to the guardian (R. 31, 33, 36).

Each trust was to be automatically revoked and to terminate at the expiration of three years from the date of creation or upon the earlier death of the taxpayer or the child-beneficiary. There was no provision for revocation prior to termination of the respective trusts but upon their termination the corpus was to go to the grantor, if living, or otherwise to his estate (R. 15, 30, 33, 35–36).

During the continuance of the trusts the grantor and his co-trustee had the authority to ~~use~~ appoint proxies to exercise voting power on the shares of stock held under the trusts (R. 31, 33, 36). The trustees were not liable for any loss except in consequence of willful and deliberate violation of their duties as trustees (R. 31, 33, 36). The resignation of Park Dougherty as co-trustee might be required by the beneficiaries (i. e., the grantor and his wife, as guardian), in which event, or should he for any other reason be unable to act, his successor was to be chosen by agreement between the taxpayer and his wife, as guardian (R. 30, 33, 36).

In each of the years 1934 and 1935, taxpayer's personal income exceeded $100,000. In his returns for those years he took credit for his three dependent children and did not include the income of the three trusts which was paid to the wife as guardian of the children under the terms of the trust instruments (R. 11–12, 14, 15, 29).

The Commissioner included in the taxpayer's taxable income for 1934 and 1935 the trust income payable to his wife as guardian of their minor children (R. 7–12, 15). Upon review, the Board of Tax Appeals held that the Commissioner's action was erroneous, seven members dissenting (R. 13–23). The decision of the Board was appealed to the United States Circuit Court of Appeals for the Eighth Circuit, and reversed. Taxpayer petitioned for certiorari, which was granted on October 14, 1940.

SUMMARY OF ARGUMENT

The court below properly considered Section 22 (a) of the Revenue Act of 1934, *infra*, in the circumstances of this case. Here the Board had already considered the question whether the grantor remained in substance the owner of the trust properties. Thus the change in the Circuit Court of Appeals amounts in effect to a mere change in nomenclature. This is particularly true since the same factors considered in *Helvering* v. *Clifford*, 309 U. S. 331, were enunciated in Article 166–1, Treasury Regulations 86, as amended, which

the Commissioner quoted in full in both his deficiency letter and his brief before the Board. A further point of much significance is that in the main briefs in the Circuit Court of Appeals, filed prior to the decision in *Helvering* v. *Wood,* 309 U. S. 344, both parties assumed that Section 22 (a) might properly be considered by the appellate court. Since the taxpayer had already considered the applicability of Section 22 (a), Revenue Act of 1934, *infra,* on its merits, he may be deemed to have waived any objection to it. At any rate the objection made on the basis of the *Wood* case is merely an afterthought. But even if it be thought that the question was not adequately raised before the Board, still the court below did not err in passing upon it on appeal in the light of the supervening decision in the *Clifford* case. Here there is no dispute about the facts and no basis for any contention by the taxpayer that he was in any way surprised or prejudiced.

The taxpayer clearly is taxable upon the trust income paid to his wife for the use and benefit of their minor children. The trusts were to continue for not longer than three years and upon termination the properties were to go to the grantor or his estate. The taxpayer retained enough of the attributes of ownership to justify treating him as owner altogether for income tax purposes.

In the alternative, the income is taxable to the grantor under Section 167 of the Revenue Act of

1934 which covers cases where income may, in the discretion of the grantor or of any person not having a substantial adverse interest, be distributed to the grantor. Here the income in question could have been applied by the wife in satisfaction of the grantor's legal obligations to support his minor children and such an application would be equivalent to a direct distribution to the grantor. The wife had no interest which would be substantially adverse to using the income for support of the children.

ARGUMENT

As in *Helvering* v. *Richter,* No. 516, this Term, the Government took the position before the Circuit Court of Appeals that under Section 22 (a) of the Revenue Act of 1934 the income from each trust payable to his wife as guardian for their minor son was taxable to the taxpayer-settlor. This proposition was accepted by the Eighth Circuit. It held that it was at liberty to consider Section 22 (a) despite the fact that the section was specifically referred to for the first time in the Government's "Points and Authorities" and brief in the Circuit Court of Appeals. The Court stated in its opinion (R. 50): "We regard the decision of the Supreme Court [in *Helvering* v. *Clifford,* 309 U. S. 331]—rendered after the filing of the opinion and order of the Board—as a matter bearing directly upon the right disposition of this case, and as having created a changed situa-

tion which it is our duty to recognize" (R. 50). The decision of the Board was therefore reversed upon the authority of the *Clifford* decision.

Respecting taxpayer's argument that the Circuit Court of Appeals should not have considered or passed upon the contention that the case at bar is governed by Section 22 (a) of the Revenue Act of 1934, we contend, as we have done in the *Richter* case, (1) that the issue or theory that the taxpayer-settlor should be "regarded as remaining in substance the owner of the corpus" presented by Article 166–1, as amended, and by Section 22 (a) was raised before and considered by the Board and was properly before the Circuit Court of Appeals; and (2) that in any event the Court of Appeals properly considered and disposed of the case under Section 22 (a).

Respecting the merits of the case we take the position that the terms of the trusts here involved render the grantor taxable on the trust income payable to his wife as guardian under Section 22 (a) or in the alternative under Section 167.

I

THE THEORY PRESENTED BY ARTICLE 166–1, AS AMENDED, AND BY SECTION 22 (a) WAS RAISED BEFORE AND CONSIDERED BY THE BOARD AND WAS PROPERLY BEFORE THE CIRCUIT COURT OF APPEALS

1. The original deficiency letter in the case at bar demonstrates that at the outset the taxpayer was put upon notice that one question relative to the

taxability of this trust income was whether the grantor remained in substance the owner of the corpus of the trust. It is true that the principal emphasis in support of this proposition was upon the short duration of the trust and the fact that the revesting of the corpus in the grantor in a subsequent year is thereby assured. However, there is also express reference to and quotations from Article 166–1 of Regulations 86, as amended by T. D. 4629. The deficiency notice contains the following statements (R. 8–9):

> There is in the opinion of this office no practical difference between the case where a grantor in terms has the power to revest in himself title to the corpus of the trust, and a case such as the instant case where the revesting of the corpus in the grantor in a subsequent year is assured by the express limitation on the terms of the trust indenture. This is the view taken in article 166–1 of Regulations 86, as amended by Treasury Decision 4629, XV–1, Cumulative Bulletin 140 (1936). Such article provides that section 166 of the Revenue Act of 1934 is not to be regarded as excluding from taxation to the grantor of the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. Such article defines "corpus" as "any part or the whole of the property, real or personal, constituting the subject matter of the trust."

It then quotes at length from the provisions of Article 166–1, as amended, which we shall not repeat at this point, but to which we direct the Court's attention (R. 9–10). These provisions refer to the *indicia* set forth in the *Clifford* case as pertinent to the question whether a settlor should be regarded as remaining in substance the owner of the corpus.

The taxpayer's petition to the Board of Tax Appeals, to which the deficiency notice above is attached, may be described as a summary statement of facts and a general denial of tax liability (R. 2–5). It does not refer specifically to any section of the Revenue Act or article of the Regulations. The Commissioner's answer constitutes in effect a general denial (R. 12, 13). As in the *Richter* case the hearing was entirely *pro forma:* the stipulation of facts was agreed upon in advance and made a part of the record, without further testimony or argument before the Board Member.

In the proceeding before the Board the Commissioner filed a brief in which his case was presented in much the same manner as in the deficiency notice. There again the Commissioner relied in part upon the Regulations previously referred to and quoted them in full. The contention made in the Commissioner's brief before the Board (Appendix B; *infra,* pp. 39–40) is as follows:

> The respondent contends that since it is the purpose of the Revenue Act of 1934, as

> provided in Section 166, to tax the income to the grantor if at any time in the future the grantor or another not having a substantial adverse interest may, under power specifically vested by the trust instrument, revest title to the corpus of the trust in the grantor, it follows *a fortiori* that the Revenue Act contemplates taxing the income to the grantor if, by the express terms of the trust instrument, title to the corpus will certainly revest in the grantor at the end of a comparatively short period. There is no practical difference between the case where a grantor in terms has the power to revest in himself title to the corpus of the trust, and a case such as the instant case where the revesting of the corpus in the grantor in a subsequent year is assured by the express limitation on the terms of the trust indenture. Here the grantor did not divest himself of title in any permanent or definitive way, did not strip himself of every interest in the subject matter of the trust estate. *The situation in legal effect would not be greatly different if the trusts had been created for a month or a week.* This construction of the statute is set forth in Treasury Decision 4629, approved March 7, 1936 (C. B. XV–1, 140), amending Article 166–1 of Regulations 86. [Italics supplied.]

From the deficiency notice and the Regulations, it is therefore apparent that the general question of the taxability of the trust was before the Board of Tax Appeals and that the matter of substantial

ownership was presented to the taxpayer and to the Board.

Whether the problem came to its attention under the Regulations or was raised *sua sponte,* the Board, in the last paragraph of its opinion actually considered the application of the theory of substantial ownership to this case. Phrasing the theory as a question, the Board inquired whether cases are applicable involving "trusts created for short periods where the grantor has reserved to himself practically all of the substantial benefits as owner of the property" (R. 18). The following appears in the Board's opinion (R. 18):

> Cases have been presented to the Board involving trusts created for short periods where the grantor has reserved to himself practically all of the substantial benefits as owner of the property, and the Board has held that such trusts are lacking in substance to such an extent that the income is taxable to the grantor. See Estate of A. C. O'Laughlin, 38 B. T. A. 1120, and cases there cited. The respondent does not argue that those cases are applicable here and obviously they are not, because here the trusts were not lacking in substance during the three years of their existence. In the case of each of these trusts the income was actually paid in accordance with the provisions of the trust instrument. They did not leave to the grantor any substantial rights and interest in, control over, or man-

> agement of the trust property during the existence of the trusts. The grantor could not use the trust property for his own benefit or enjoyment. Thus, these trusts cannot be disregarded and it cannot be said that they fall within section 167 because a part of the income of the trusts might be distributed to the grantor or held for future distribution to him.

When the matter came before the Circuit Court of Appeals, it pointed out (111 F. (2d) 1, 6; R. 49) that—

> In this case there is no dispute about the facts. The question of the taxability to the taxpayer of the income of these trusts was in a broad sense before the Board. In its opinion it referred to rulings to the effect that the income of trusts under which there was reserved to the grantor practically all of the substantial benefits as owner were taxable to him.[1]

Thus it seems clear that at each step in this proceeding the taxpayer was made fully aware of the possible application of the theory of substantial ownership to the case at bar. The situation here is analogous to that in the *Clifford* case where the theory was considered by the Board and the Circuit Court of Appeals without the label of Section 22 (a). Here, too, the court below recognized that

[1] The court then quoted, as a footnote, part of the last paragraph of the Board's majority opinion, already quoted above.

the taxability of the trusts was in a broad sense before the Board. Its decision holding that the income should be deemed taxable under Section 22 (a) is analogous to the action of this Court in the *Clifford* case.[2]

In much the same way as in *Commissioner* v. *Berolzheimer* (C. C. A. 2d), decided December 23, 1940, not yet reported but found in 1941 C. C. H., Vol. 4, par. 9156, the Board here raised and considered the question whether "the provisions of each trust instrument gave the grantor such control over the corpus of the trust that 'in reality there was no trust.'" The conclusion of the Second Circuit in that case is equally applicable to these facts: "The government is doing no more here than giving new reasons why the income of the trusts is taxable against the settlers under Section 22 (a)."[3] Thus the change in nomenclature clearly does not warrant a claim of surprise, particularly where the precise factors considered in *Helvering* v. *Clifford, supra,* were enunciated in Article 166–1 which the Commissioner quoted in full in his deficiency letter and in his brief before the Board. The quoted Regulations show unmistakably that Article 166–1, as amended, is not

[2] There is no indication in the *Clifford* opinion that this Court was considering a theory of liability not raised before the Board. See 309 U. S. 331.

[3] But cf. *Helvering* v. *Achelis*, 112 F. (2d) 929 (C. C. A. 2d). There, the Circuit Court of Appeals refused to consider Section 22 (a). However, the Commissioner presented no argument and filed no brief before the Board.

based solely upon Section 166 nor confined to the types of trusts therein specified. Rather, as this Court recognized in *Helvering* v. *Clifford,* 309 U. S. 331, 334n., they show that "Art. 166–1 of Treasury Regulations 86 promulgated under § 166 of the 1934 Act" was "in 1936 amended (T. D. 4629) so as to rest on § 22 (a) also".

A further point of much significance is that in the main briefs in the Circuit Court of Appeals, filed prior to the decision of *Helvering* v. *Wood,* 309 U. S. 344, both parties assumed that Section 22 (a) might properly be considered by the appellate court (See Appendices C and D, *infra,* pp. 47–49). As pointed out in the opinion of the court below (R. 45–46):

> The taxpayer, in his answering brief, under "Points and Authorities", stated:
>
> "1. Grantor gave up sufficient interest in the trust income to avoid taxation under Sections 167 and/or 22 (a) of the Revenue Act of 1934.
>
> "2. The grantor gave up sufficient interest in the trust corpus to avoid taxation therefrom under Sections 166 and/or 22 (a) of the Revenue Act of 1934.
>
> "3. Grantor did not retain sufficient interest in the income and the corpus of the trust to justify taxing him under Sections 166, 167, and 22 (a), considered together and read as a whole."

Section 22 (a) was discussed without objection by the taxpayer who relied *inter alia* upon *Clifford*

v. *Helvering,* 105 F. (2d) 586, also decided by the Circuit Court of Appeals for the Eighth Circuit. The argument of the appeal was adjourned from December 1939 to March 1940, because of the illness of one of the taxpayer's lawyers. The opinion in the *Wood* case was rendered February 26, 1940, whereupon the taxpayer *in a supplemental brief for the first time* contended that Section 22 (a) could not properly be considered on appeal. See opinion of the court below (R. 44–47). The tardiness of taxpayer's objection demonstrates not only that he was not misled, but also raises the likelihood of a waiver of any objection to the consideration of the issue by the Circuit Court of Appeals. Since the taxpayer had already discussed the applicability of Section 22 (a) *on its merits,* the objection made on the basis of the *Wood* case amounts to no more than an afterthought.

In view of these circumstances, we submit that in both the *Richter* case and the case at bar the question as to Section 22 (a) was sufficiently before the Board to preclude any contention by the taxpayer that he was surprised or prejudiced when the point was specifically raised on appeal. It is our position that the theory of substantial ownership had already been raised and was considered by the Board, and that the only change in the Circuit Court of Appeals was in the label which the theory received. We further contend that by first answering the argument with respect to Sec-

tion 22 (a) on its merits, taxpayer waived his objection to its proper application here. Finally, we submit that even if the theory of substantial ownership was not in fact raised before or considered by the Board, nevertheless the case might be considered on appeal in the light of the supervening *Clifford* decision, especially since the facts were not in dispute and only a question of law was involved. The arguments in this connection are more fully set forth in our brief in *Helvering* v. *Richter, supra* (Points I and II thereof), to which we respectfully refer the Court. Cf. also *United States* v. *Williams,* 278 U. S. 255, 256.

II

THE GRANTOR IS TAXABLE UNDER SECTION 22 (A) BECAUSE HE REMAINED IN SUBSTANCE THE OWNER OF THE TRUST CORPUS

The court below in reversing the Board said (R. 47–48) that there are no controlling distinctions between the short-term family trusts here in suit and the trust which was involved in *Helvering* v. *Clifford, supra.* In the latter case the grantor was held taxable under Section 22 (a) on trust income paid to his wife as beneficiary where the trust was to continue for a short term of five years or until the prior death of the taxpayer or his wife. By the terms of the instrument the grantor was empowered to pay over to his wife the whole or such part of the income as he in his discretion might determine; upon termination of the trust the corpus

was to go to the grantor or his estate but any undistributed net income was to be treated as the property of the wife. Respecting the expenditure of the income which the grantor's wife was to receive from the trust, it was stipulated that she had substantial income of her own from other sources and that there was no restriction of her use of the trust income, all of which was placed in her personal checking account and intermingled with her other funds, and further that the trust was not designed to relieve grantor from liability from family or household expenses. During the continuance of the trust the grantor as sole trustee had broad powers of control over the trust property.

The facts in the case at bar closely parallel those in the *Clifford* case, with a few minor exceptions. Here the beneficiary of the trusts was the taxpayer's wife, as guardian, for the use and benefit of their minor children in amounts not to exceed $2,000 per annum for each child. There was no finding as to the use of the money disbursed. The trusts here are of shorter duration than the one in the *Clifford* case, terminating at the expiration of three years from date of creation or upon the death of either the grantor or the child beneficiary.

The only significant deviation from the *Clifford* trust is that here there were two trustees of whom one was the grantor, rather than merely one trustee, the grantor himself.

While it may be that, as urged by the taxpayer (Br. 22–23), action by both of the trustees would be necessary to the exercise of the powers conferred upon them (Restatement of the Law of Trusts, Vol. 1, Sec. 194), still the record furnishes no basis for any conclusion that Dougherty, the cotrustee, would not have complied with the grantor's wishes in regard to management of the trusteed property. A trustee as such is not a beneficially nor substantially interested party. *Reinecke* v. *Smith,* 289 U. S. 172, 174; *Morton* v. *Commissioner,* 109 F. (2d) 47, 50 (C. C. A. 7th). Moreover, the grantor and his wife could have dismissed Dougherty at any time, and under such circumstances there seems little basis for presuming that he would have opposed any authorized action proposed by the grantor with respect to the trusts. Cf. *Rollins* v. *Helvering,* 92 F. (2d) 390, 394–395 (C. C. A. 8th), certiorari denied, 302 U. S. 763; *Fulham* v. *Commissioner,* 110 F. (2d) 916, 918 (C. C. A. 1st); *Cox* v. *Commissioner,* 110 F. (2d) 934, 936 (C. C. A. 10th), certiorari denied, No. 198, this Term; but cf. *Knapp* v. *Hoey,* 104 F. (2d) 99, 102 (C. C. A. 2d).

It may also be that the co-trustees here would have no power to sell trust property in the absence of a court order (Mason's Minnesota Statutes, 1927, Vol. 3, c. 60, Sec. 8100–1), since the trust instruments did not expressly give them such power. Cf., however, *Warner Hardware Co.* v. *Shimon,* 186 Minn. 229, 234. But this did not

lessen the control of the grantor; on the contrary, it emphasized his dominion over the property placed in trust. Generally speaking, nobody could sell it without his consent and if he had wished to make a sale it is improbable that his co-trustee would have opposed application for a court order, particularly in view of the provision in the trust deeds to the effect that in case of sale of the stock initially deposited, and the substitution of other securities therefor, the income therefrom was to be trust income (R. 43, 31, 34, 37).

A further significant factor of control is that the taxpayer and his co-trustee had the power to vote the trusteed securities, all being stock of the Hormel Co., of which he was an officer. See *Helvering* v. *Fuller,* 310 U. S. 69, 76.

In these circumstances, we submit that the rule in the *Clifford* case, *supra,* is clearly applicable here, for the grantor retained enough of the attributes of ownership of the trusteed property to justify treating him as owner altogether for income tax purposes. Cf. *Du Pont* v. *Commissioner,* 289 U. S. 685, 688–689.

Moreover, the instant case is substantially similar to cases holding that the assignment of future income from property retained or services performed by the assignor does not relieve him from tax. *Helvering* v. *Horst,* decided by this Court on November 25, 1940; *Helvering* v. *Eubank,* decided by this Court on November 25, 1940; *Burnet* v.

Leininger, 285 U. S. 136; *Lucas* v. *Earl,* 281 U. S. 111; see *Reinecke* v. *Smith,* 289 U. S. 172, 177.

The grantor here assigned certain rights to income from the property placed in the trusts but he remained in substance the owner of that property and consequently is taxable on the income derived therefrom.

The taxpayer asserts (Br. 21–22) that the question as to substantial ownership is one of fact and that the Board's determination thereof should be final. But we submit that the question is essentially one of law or at least a mixed question of fact and law (cf. *Bogardus* v. *Commissioner,* 302 U. S. 34), so that the Circuit Court of Appeals was not precluded from reviewing the decision of the Board in this respect. *Commissioner* v. *Berolzheimer* (C. C. A. 2d), decided December 23, 1940, not yet officially reported, but found in 1941 C. C. H., Vol. 4, par. 9156; *White* v. *Higgins* (C. C. A. 1st), decided December 13, 1940, not yet officially reported, but found in 1941 C. C. H., Vol. 4, par. 9136.[4] And even were the question to be

[4] In the *Higgins* case, the Circuit Court of Appeals (per Magruder, J.) stated:

"A point of procedure remains. At several places in its opinion, the Supreme Court in the Clifford case seems to regard the basic issue whether the grantor remains in substance the owner of the corpus as a question of fact; calling for appropriate findings by the trier of fact. Since the issue may depend not only upon an analysis of the terms of the trust but also upon "all the circumstances attendant on its creation and operation" (309 U. S. at 335), there may

treated as one of pure fact, the result would be the same for it seems clear that under the correct rule of law there is no substantial evidence to support a finding that the taxpayer in the instant case was not in substance the owner of the corpus of each trust.

III

IN THE ALTERNATIVE, THE GRANTOR DID NOT GIVE UP SUFFICIENT INTEREST IN THE TRUST INCOME TO AVOID TAXATION UNDER SECTIONS 167 AND 22 (A) OF THE REVENUE ACT OF 1934

Section 167 (a) (2) of the Revenue Act of 1934 (Appendix A, *infra*) provides that where any part of the income of a trust "may, in the discretion of the grantor or of any person not having a substan-

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be cases where questions strictly of fact are presented. However, in the Clifford case, the considerations mentioned by the court as supporting the conclusion that the grantor remained in substance the owner of the corpus, were all derived from the terms of the trust instrument.

"In the present cases the District Court has made no finding either way on the issue whether the grantors remained owners of the corpus of the respective estates, because the court did not think that Section 213 could be considered. But on the record before us, it would not be appropriate to remand the cases for further findings of fact. The underlying facts have been stipulated, and there seems to be nothing outside the terms of the trust instruments bearing on the 'basic issue.' The District Court is in no better position than we are to draw the ultimate conclusion. An examination of the trust instruments, in the light of the Clifford case and its rationale, leads us to the conclusion that as a matter of law the income of the trusts is taxable to the respective grantors. The taxpayers are not entitled to the claimed refunds."

tial adverse interest in the disposition of such part of the income, be distributed to the grantor," then such part of the income shall be included in computing the net income of the grantor.

There is no doubt that the taxpayer was under a continuing legal obligation to support his children in accordance with their needs and station in life. *Knutson* v. *Haugen,* 191 Minn. 420. It is also settled that, for income-tax purposes, a distribution of trust income at the direction of the grantor to the discharge of such an obligation owing by the grantor is treated as the equivalent of a receipt of income by him. *Douglas* v. *Willcuts,* 296 U. S. 1, 9; *Helvering* v. *Schweitzer,* 296 U. S. 551, reversing 75 F. (2d) 702 (C. C. A. 7th); *Helvering* v. *Coxey,* 297 U. S. 694, reversing 79 F. (2d) 661 (C. C. A. 3d); *Commissioner* v. *Grosvenor,* 85 F. (2d) 2 (C. C. A. 2d); *Helvering* v. *Leonard,* 105 F. (2d) 900 (C. C. A. 2d), reversed on another point, 310 U. S. 80. Accordingly, we submit that trust income, payable to the taxpayer-grantor's wife for the benefit of their minor children, which could be applied by her towards their maintenance and support, thereby relieving the taxpayer of his obligation to support his children, is income that could be distributed for his benefit or "to the grantor" within the meaning of Section 167. The only question remaining then is whether the income from the trusts under scrutiny could have been so applied.

The regulations, both as originally adopted,[5] and as amended (Appendix A, *infra*), support the construction of the statute here contended for;[6] they

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[5] Treasury Regulations 86, promulgated under the Revenue Act of 1934:

"ART. 167–1. TRUSTS IN THE INCOME OF WHICH THE GRANTOR RETAINS AN INTEREST.—* * *

"(*b*) *Test of taxability to the grantor.*—The test of the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether the grantor has failed to divest himself, permanently and definitively, of every right which might, by any possibility, enable him to have the income, at some time, distributed to him, actually or constructively. Such a distribution to the grantor occurs if the income is paid to him or to another according to the grantor's direction or if, though paid to another pursuant to the terms of the trust, the benefit of the income inures to the grantor. The income so inures if it is or may be applied in satisfaction of a legal obligation of the grantor * * *.

* * * * *

"If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

* * * * *

"(4) whether, if such distribution results in the inuring of benefits to the grantor from the application of the income in satisfaction of his legal obligation, such obligation is to pay a debt, to support dependents, to pay alimony, to furnish maintenance, and support or otherwise;"

* * * * *

[6] It is true that following the Board's decision in *Black* v. *Commissioner*, 36 B. T. A. 346, the Chief Counsel, Bureau of Internal Revenue, ruled that where trust income may, in the discretion of the trustee, be used for support of the grantor's minor children, only so much thereof as is actually so applied may be taxable to the grantor (G. C. M. 18972, 1937–2 Cum. Bull 231, 233) and that ruling was followed in *Hudson* v. *Jones*, 22 F. Supp. 938 (W. D. Okla.). But

have remained without substantial modification through the 1936 and 1938 reenactments of the law (Revenue Act of 1936, c. 690, 49 Stat. 1648, Sec. 167; Revenue Act of 1938, c. 289, 52 Stat. 447, Sec. 167); we submit that the departmental construction adopted contemporaneously with the enactment of the law and of such long-continued standing should be approved. Compare *Taft* v. *Commissioner,* 304 U. S. 351.

The taxpayer does not appear to oppose our construction of the statute which has been embodied in the regulations. His position, on the contrary, appears to be that (irrespective of our

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we submit that, to the extent that it is inconsistent with the views herein expressed in the text, the ruling is incorrect and out of harmony with the regulations.

The Board of Tax Appeals has drawn a distinction between (1) cases where the trustee or guardian has the power to use trust income for support of the grantor's children and (2) cases where the grantor has retained such power as an individual. It holds that in the first type of case only the income actually so used is taxable to the grantor (*Black* v. *Commissioner*, *supra; Chandler* v. *Commissioner*, 41 B. T. A. 165, 178, appeal to the Circuit Court of Appeals for the Third Circuit pending; *Deuble* v. *Commissioner*, 42 B. T. A. 277, 288; *Johnston* v. *Commissioner*, 41 B. T. A. 550, 556); and in the latter, it holds that the grantor is taxable under Section 167 (a) (2) on all income which could have been so used. *Pyeatt* v. *Commissioner*, 39 B. T. A. 774, 780; *Whitely* v. *Commissioner*, 42 B. T. A. 402, 416–418, appeal to the Circuit Court of Appeals for the Third Circuit pending. We submit that the distinction is not substantial and should be disapproved. The statute and the regulations operate to tax the grantor in both instances.

construction) his wife had a "substantial adverse interest" to the application of the trust income in such a manner as to relieve him of his obligation to support their children. In support of his position, he cites a Minnesota statute (Mason's Minnesota Statutes, 1927, Vol. 3, 1940 Supp., c. 74, Sec. 8992–135) which reads, in part, as follows:

> 8992–135. *Guardian's duties.*—A guardian shall be subject to the control and direction of the court at all times and in all things. A general guardian of the person shall have charge of the person of the ward. A general guardian of the estate shall (1) pay the reasonable charges for the support, maintenance, and education of the ward in a manner suitable to his station in life and the value of his estate; but nothing herein contained shall release parents from obligations imposed by law for the support, maintenance, and education of their children. * * *

The quoted statutory provision clearly does not preclude a parent from discharging his obligation to support, maintain, and educate his children through the utilization of a trust device. It may assure the existence of a continuing obligation on the part of the parent, but it certainly does not purport to control the means by which the parent can discharge that continuing obligation. And no authority has been produced by the taxpayer holding or even intimating that a trust like those under scrutiny would not be an entirely appropriate

means of discharging the obligations owing by him to his children. Furthermore, and more to the point, no authority has been brought forward to support the assertion that in the circumstances here the wife would not have been fully authorized to apply the income from the trusts created by the taxpayer for the support, maintenance, and education of his children. In the absence of such authority, forbidding the application, there would appear to be no reason for regarding the wife as having a "substantial adverse interest" to such an application of the trust income. *Reinecke* v. *Smith,* 289 U. S. 172, 174; *Morton* v. *Commissioner,* 109 F. (2d) 47, 50 (C. C. A. 7th). The taxpayer therefore has failed to meet the burden of proof required of him in this type of case, and the trust income is taxable to him under Section 167 (a) (2). See *Helvering* v. *Leonard,* 310 U. S. 80, 87; *Helvering* v. *Fitch,* 309 U. S. 149, 151, 156.

Moreover, we submit, the record in this case does not show what use the wife made of the trust income which was paid to her for the benefit of the minor children. It is quite possible, so far as appears, that such income was in fact used for their support, maintenance, or education. If that is the case, then the taxpayer (their father) would appear to be taxable on the income which was used to discharge his obligation under the authority of the *Douglas* and *Schweitzer* cases cited above. And since this Court has held that the taxpayer "has the burden of establishing that his case falls out-

side the general rule of *Douglas* v. *Willcuts*" it follows that, on the present record, the income must be assumed to have been so used. See *Helvering* v. *Leonard*, 310 U. S. 80, 87; *Helvering* v. *Fitch*, 309 U. S. 149, 151, 156.

Although the question as to Section 167 (a) (2) was decided adversely to the Commissioner by the Board, seven members dissenting, and by the court below, the point is available here as a ground of defense. Cf. *Helvering* v. *Gowran*, 302 U. S. 238, 245–246; *Riley Investment Co.* v. *Commissioner*, decided by this Court on November 12, 1940, not yet reported. But it is presented only in the alternative and need not be considered if the Court agrees with us that the grantor was taxable under Section 22 (a) (pp. 7–21, *supra*).

CONCLUSION

The judgment of the court below should be affirmed.

Respectfully submitted.

FRANCIS BIDDLE,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
L. W. POST,
WILLIAM L. CARY,
Special Assistants to the Attorney General.
EDWIN E. HUDDLESON, JR.,
Attorney.

FEBRUARY 1941.

APPENDIX A

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (U. S. C., Title 26, Sec. 22.)

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor. (U. S. C., Title 26, Sec. 166.)

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o) relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question. (U. S. C., Title 26, Sec. 167.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22 (a)–1. *What included in gross income.*—Gross income includes in general

compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See secs. 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

ART. 166–1 [as amended by T. D. 4629, XV–I Cum. Bull. 140, 141 (1936), and T. D. 4759, 1937–2 Cum. Bull. 117, 118]. *Trusts, with respect to the corpus of which, the grantor is regarded as remaining in substance the owner.*—(*a*) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163, but remains attributable and taxable to the grantor. This article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(*b*) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to

revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

(1) whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend or to appoint;

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor

has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used, nor on the technical description which the law of property gives to the estate or interst transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor, or those which he would ordinarily and naturally make; and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from such property to be used by the trustee during such period to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while

the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trust in order to conserve the property, not for himself but for the donees, who will ultimately enjoy it, the provisions of sections 161, 162, and 163 are applicable.

(*c*) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(C) for the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the

income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

(*d*) If the grantor is regarded as remaining in substance the owner of the corpus the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created.

If the grantor strips himself of the substantial incidents or attributes of ownership in the corpus retained by him so that he ceases to be regarded as in substance the owner of the corpus, the income thereof realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus or the income therefrom. If the power to revest title in the grantor is vested in him in conjunction with such person, or is vested solely in such person, there is to be excluded in computing the net income of the grantor only the income of such part.

ART. 167–1 [as amended by T. D. 4759, *supra,* and T. D. 4860, 1938–2 Cum. Bull. 184]. *Trusts in the income of which the grantor retains an interest.*—(*a*) *Scope.*—

Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, not because the grantor has retained a certain interest in the *corpus* of the trust (as in section 166), but because of his retention of a certain interest in the *income* of the trust. This article deals with the taxation of such income. The term "income," as used in this article, means any part or the whole of the income of the trust.

(*b*) *Test of taxability to the grantor.*—The test prescribed by the Act as to the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether he has failed to divest himself, both permanently and definitely, of every right which might, by any possibility, enable him to have such income, at some time, distributed to him, either actually or constructively. Such a distribution to the grantor occurs within the meaning of section 167 if the income is paid to him or to another in obedience to his direction or if the income is applied in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this article, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right to so effect or direct the distribution of income is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor.

If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

(1) whether it may be distributed currently or accumulated for future distribution;

(2) whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) whether, if such distribution is in any way effected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(4) the time or times of such distribution, whether within or without the taxable period, whether conditioned on the precedent giving of notice, or on the elapsing of an interval of time, or on the happening of a specified event, or otherwise;

(5) when the trust was created.

Thus the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. But the provisions of section 167 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the trust income. If, for example, trust income is applied in satisfaction of the grantor's legal obligation whether to pay a debt, to support dependents, to pay alimony, to furnish maintenance and support, or otherwise, such income is in all cases taxable to the grantor.

If the grantor strips himself permanently and definitively of every such interest retained by him, the income of the trust

realized after such divesting takes effect is not taxable to the grantor but is taxable as provided in sections 161 and 162.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the income. There is to be excluded in computing the net income of the grantor only that part of the trust income in the disposition of which such person has a substantial interest adverse to the grantor.

(c) *Income and deductions.*—If, as to any of the income, the test of taxability to the grantor is satisfied, such income shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such income as he would have been entitled had such income been distributable currently to him.

APPENDIX B

EXCERPTS FROM THE GOVERNMENT'S BOARD BRIEF IN THIS CASE (PP.19–26)

* * * * *

The said trusts, by their every term and provision wherein the income was to be paid to the several members of the grantors' families for a limited time, and at the same time the corpus was to be supervised by the grantors or the members of their families as trustees, disclose their true purpose was to avoid surtaxes. Although the dividends were actually distributable, the beneficiaries had no right or title thereto until actually paid or delivered to them. The trust agreements contained a certain restriction upon alienation of the income before its actual payment and receipt by the beneficiaries (Article #4 of Trust 9 and Article #5 of Trusts 1, 3, 4 and 5).

The trust instruments by their own specific terms were irrevocable except by happening of the events which automatically terminated them, when the corpus "shall be deemed and treated as property owned absolutely" by the grantors as of the same time. The happening of the said events resulting in termination operated to revest the corpus in the grantors if they were ever divested.

The petitioners contend that the "income" distributed to the several beneficiaries of the trust is not taxable to them (Docket Nos. 93571 and 93572); and if so, then the transfer of the stock to the trusts

is not also subject to gift tax (Issue B of Amended Petitions, Docket Nos. S9114 and S9115). The question presented herein for decision is whether the grantors of the aforementioned trusts retained such an interest either in the corpus or the income of the trusts as to require the taxation of the income thereof to them.

The petitioners contend that the phrase "power to revest" as used in *Section 166* should be literally interpreted and that, inasmuch as the grantors did not have power to revest, but held only a reversionary interest under which the corpus of the trusts reverted to them, if living, upon the death of their wives, or the expiration of three years in the case of their children, the trusts herein involved fall outside of the scope of *Section 166*. They further contend that, even if the term "power to revest" be interpreted to include within its scope such a trust as the ones involved herein, the income of the trusts is nevertheless not taxable to the grantor because the event upon which the revesting will occur is contingent and uncertain.

The respondent contends that since it is the purpose of the *Revenue Act of 1934*, as provided in *Section 166*, to tax the income to the grantor if at any time in the future the grantor or another not having a substantial adverse interest may, under power specifically vested by the trust instrument, revest title to the corpus of the trust in the grantor, it follows *a fortiori* that the Revenue Act contemplates taxing the income to the grantor if, by the express terms of the trust instrument, title to the corpus will certainly revest in the grantor at the end of a comparatively short period. There is

no practical difference between the case where a grantor in terms has the power to revest in himself title to the corpus of the trust, and a case such as the instant case where the revesting of the corpus in the grantor in a subsequent year is assured by the express limitation on the terms of the trust indenture. Here the grantor did not divest himself of title in any permanent or definitive way, did not strip himself of every interest in the subject matter of the trust estate. The situation in legal effect would not be greatly different if the trusts had been created for a month, or a week. This construction of the statute is set forth in *Treasury Decisions 4629,* approved March 7, 1936, (C. B. XV–1, 140) amending *Article 166–1 of Regulations 86.* The article as amended contains the following provisions:

> Trusts with respect to the corpus of which the grantor is regarded as remaining in substance the owner.—(a) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163 but remains attributable and taxable to the grantor. This article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.
>
> (b) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is

deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

* * * * *

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come:

* * * The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

* * * In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarily and naturally make; and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the

substantial incidents of ownership in the corpus.

* * * it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of these property rights which consist of the right to the expected future income of the corpus for the specified period. * * *

(c) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; * * *.

The provisions of *Section 166* of the *Revenue Act of 1934* have been reenacted without alteration in the Revenue Act of 1936 in the face of its interpretation by the Commissioner, by his regulations above quoted. The substance of the Treasury Decision has also been adopted as the regulation under subsequent revenue acts.

Such article as amended provides that *Section 166* of the *Revenue Act of 1934* is not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor, for the purposes of the Act, is similarly regarded as remaining in substance the owner of the corpus. Such article defines "corpus" as "any part or the whole of the property, real or personal, constituting the subject matter of the trust."

The grantors have retained a sufficient interest in the corpus of the trust resulting in the taxation

of its income to them, in that they have failed to divest themselves, permanently and definitely, of every right which might by any possibility enable them once more to possess and enjoy in title the trust corpus.

It is true the trust instruments were irrevocable by their specific terms during the period of their existence, and the grantors had no power to revest themselves of any corpus of the trusts during the limited period. However, the trusts were automatically revoked at the end of the period without any positive action on their part.

There is no substantial distinction between a trust where the grantor has literally retained the power or ability to revest and one where the revesting takes place without any action on the part of the grantor. It would appear somewhat meaningless to distinguish between the two types of trusts.

Here the grantors, by using a different form of words, have attained the same end and will escape the surtax imposed upon them if they are not held taxable on the income.

Having in mind the purpose of the statute and the breadth of its language, it would seem to be of no consequence what particular conveyancing device—what particular strings—the grantors selected to hold in suspense their right and title to the property and the ultimate disposition of it.

Cf. *Corliss* v. *Bowers,* (1930) 281 U. S. 376, in which the Court stated: "But taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid." (Also see *Reinecke* v. *Smith,* (1933) 289 U. S. 172.)

It is accordingly submitted that the retention by a grantor of a reversion of the corpus of a trust after a short term of years constitutes the retention of such an interest in the corpus as will permit the taxation of the income of the trust to the grantor.

The respondent recognizes that the Board has ruled that trusts similar to the ones here involved—especially Trusts No. 1 and No. 9—do not come within the scope of *Section 166, supra.* (Cf. *Meredith Wood,* (1939) 37 B. T. A. No. 157 and cases cited; *Henry A. B. Dunning,* (1937) 36 B. T. A. 1222.) The respondent has not acquiesced in these decisions and has petitioned the higher courts for a review.

In *DuPont* v. *Commissioner,* (1933) 289 U. S. 685, the Supreme Court had under consideration the question of whether the income of trusts created for a period of 3 years, and which were irrevocable during that period, with provisions for successive extensions, was taxable to the grantor under the provisions of the Revenue Acts of 1924 and 1926. Two policies of insurance on the life of the grantor and shares of stock in a corporation were transferred to the trusts, the income from the stock to be used to keep the policies in force. It was provided as to the policies that if the trusts should terminate before the grantor's death, all interest in the policies should rest in certain named beneficiaries, of which the grantor was not one. The grantor had no power to change the beneficiaries. It was provided that if the grantor should die while the trusts were still in force, the trustees should collect the insurance and hold the proceeds in trust for the use of the beneficiaries named in

the agreements. It was further provided that if the trusts should terminate before the grantor's death, the shares of stock and any income not paid out should be transferred to the grantor. If, however, he should die while the trusts were still in force, the shares were to be divided among the grantor's children or their issue. In that case the Supreme Court decided that Section 219 (h) of the Revenue Acts of 1924 and 1926 is consistent with the Fifth Amendment of the Constitution, in its application to trusts for the payment of premiums on policies of insurance. The Supreme Court also stated:

> The case is ruled by our judgment in *Burnet* v. *Wells,* ante P. 670, upholding the validity of the contested statute. If the income of such a trust may be taxed to the grantor though he has retained to himself no reversionary interest in the principal of the trust, a fortiori that result must follow where he has made a grant of the estate for a short term of years, reserving the reversion when the term is at an end.
>
> The provisions of these deeds would require a determination in favor of the Government, though *Burnet* v. *Wells* had been decided the other way. "A statute may be invalid as applied to one state of facts and yet valid as applied to another." *Dahnke-Walker Co.* v. *Bondurant,* 257 U. S. 282, 289. Here the grantor did not divest himself of title in any permanent or definitive way, did not strip himself of every interest in the subject matter of the trust estate. During a term of three years, the trustee was to apply the income to the preservation of the policies, and while thus applying the in-

> come was to hold the principal intact for return to the grantor unless instructed to retain it longer. The situation in its legal effect would not be greatly different if the trusts had been created for a month or from day to day. One who retains for himself so many of the attributes of ownership is not the victim of despotic power when for the purposes of taxation he is treated as owner altogether.

In the above case, four Justices of the Supreme Court concurred upon the reasons stated in the last paragraph quoted above. Those same Justices who concurred in that case dissented in the case of *Burnet* v. *Wells,* (1933) 289 U. S. 670, in which case it was held that *Section 219 (h)* of the *Revenue Acts of 1924 and 1926* is constitutional. It thus appears that all of the Justices of the Supreme Court concurred in the conclusion that the retention by a grantor of a reversion of the corpus of a trust after a short term of years constitutes the retention of such an interest in the corpus as will permit the taxation of the income of the trust to the grantor.

* * * * *

APPENDIX C

Extract from Commissioner's main brief in the Circuit Court of Appeals for the Eighth Circuit, (pp. 7–8):

III

The grantor retained sufficient interest in the income and corpus of the trusts to justify taxing him under Sections 167, 166, and 22 (a), considered together and read as a whole

In addition to the considerations hereinbefore set forth, we urge that the interest retained by the grantor in the income and corpus of the trusts was sufficient to justify the Commissioner in treating him as the owner of the properties and the income therefrom and in taxing him on such income under Sections 167, 166 and 22 (a) of the Revenue Act of 1934, considered together and read as a whole. Cf. *DuPont* v. *Commissioner,* 289 U. S. 685, where irrevocable trusts to pay premiums on policies of insurance on the grantor's life were to last for a period of three years, at the expiration of which they might be extended for a similar period. In holding valid the provisions of the statute which required the grantor to account for the income of the trusts (Section 219 (h) of the Revenue Act of 1924, c. 234, 43 Stat. 253, and the Revenue Act of 1926, c. 27, 44 Stat. 9, which corresponds to Section 167 of the Revenue Act of 1934), the Court said (pp. 688–689):

"Here the grantor did not divest himself of title in any permanent or definitive way,

did not strip himself of every interest in the subject matter of the trust estate. During a term of three years, the trustee was to apply the income to the preservation of the policies, and while thus applying the income was to hold the principal intact for return to the grantor unless instructed to retain it longer. The situation in its legal effect would not be greatly different if the trusts had been created for a month or from day to day. One who retains for himself so many of the attributes of ownership is not the victim of despotic power when for the purpose of taxation he is treated as owner altogether."

Similarly, in the instant case, the trusts were to terminate after three years or the earlier deaths of the children or the grantor and upon termination the properties were to be restored to the taxpayer or his estate. The grantor was also to receive all income over the $2,000 per annum applicable to the use and benefit of each minor child. Clearly here, as in the DuPont case, the taxpayer did not part with sufficient interest in the trust properties to justify treating him otherwise than as owner of the same and taxable on the income therefrom.

APPENDIX D

Extract from respondent's main brief in the Circuit Court of Appeals for the Eighth Circuit (p. 22):

III

The grantor did not retain sufficient interest in the income and corpus of the trust to justify taxing him under Sections 166, 167, and 22 (a), considered together and read as a whole.

Here petitioner contends that the interest retained by the grantor in the income and corpus was sufficient to justify treating him as the owner of the properties and income and taxing him under the sections referred to supra, and cites the case of *Dupont* v. *Commissioner,* 289 U. S. 685. The case cited is one involving the question of payment of premiums upon life insurance policies on the grantor's life. The court merely held that the grantor did not divert himself of title in any permanent or definitive way, as during the term of the trusts the trustee was to apply the income to the preservation of policies. In the instant case, there is no restriction whatsoever upon the application and no restriction whatsoever upon the use of the income. Grantor merely holds the reversionary right, having no power to revest any of the income of the trusts for his own benefit. There is no provision in the trust agreement for alteration, amendment, or revocation. See paragraph 6, page 31 of the record.

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SUPREME COURT OF THE UNITED STATES.

No. 257.—October Term, 1940.

Jay C. Hormel, Petitioner, *vs.* Guy T. Helvering, Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[March 17, 1941.]

Mr. Justice Black delivered the opinion of the Court.

The Commissioner of Internal Revenue assessed a deficiency against petitioner for failure to include in his 1934 and 1935 tax returns the income of three separate trusts declared by him in 1934. Each of the declarations of trust recited that the beneficiaries were "Jay C. Hormel [petitioner himself], and Germaine D. Hormel, his wife, as guardian for their son," a different son being designated by each trust instrument. Each trust estate consisted of shares of stock in Geo. A. Hormel & Co., of which petitioner was an officer. Petitioner named himself and another as co-trustees; all dividends from each trust estate, up to $2000 a year, were to be paid to petitioner's wife as guardian for the son named in the particular trust instrument, and any excess over $2000 was to be paid to petitioner; the trusts were to expire automatically after three years, or upon the death of petitioner, or upon the death of the named son, whichever event should occur first; upon expiration of each trust, the entire principal should be the property of petitioner, his legatees, devisees, or heirs; petitioner and his wife (as guardian) had the power to remove petitioner's co-trustee at any time, and to choose a successor; the co-trustees could appoint proxies to exercise voting rights over the shares of stock making up the trust estates, and could sell the securities deposited and substitute others; it was provided that no title to the trust estates should vest in petitioner's wife, as guardian, or in his sons, and it was further provided that the wife and sons should have no power "to sell, transfer, encumber or in any manner anticipate or dispose of any interest in the trust estate"; and, finally, the trust instruments stated that the co-trustees were to be responsible for loss only upon wilful and deliberate violations of their duties.

All of the trust income for the years in question was distributed to petitioner's wife as guardian, who reported it to the federal government as guardianship income. Petitioner, in his individual returns, did not include it. The Commissioner, taking the position that petitioner should have included the trust income in his individual returns, assessed a deficiency against him, asserting that the trusts were "revocable" and the income therefore petitioner's within the meaning of section 166 of the Revenue Act of 1934.[1] The Board of Tax Appeals decided against the Commissioner, holding that the income in question was taxable to petitioner neither under section 166 nor 167,[2] the two sections expressly relied on by the Commissioner before the Board. In the Circuit Court of Appeals, the Commissioner abandoned reliance on section 166, urged that the Board was in error as to taxability under section 167, and argued that in any event the income was taxable to petitioner under section 22(a).[3] The taxpayer argued that the applicability of section 22(a) was not open for consideration, inasmuch as that section had not been relied on before the Board. The Circuit Court of Appeals, though agreeing with the Board as to non-taxability under sections 166 and 167, nevertheless ruled that section 22(a) could properly be considered, and held the income taxable to petitioner under that section. Because of a con-

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1 "Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

"(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

"(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor."

2 Section 167 reads in part as follows: "(a) Where any part of the income of a trust—

"(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

"(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; . . ."

3 " 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . ."

flict among the Circuit Courts of Appeals on the propriety of considering section 22(a) under these circumstances,[4] we granted certiorari. 311 U. S. —. Two questions are presented for our decision: First, Was the court below correct in holding that section 22(a) should be considered? Second, If so, was the court below justified in determining that the income of these trusts was taxable to petitioner under section 22(a)?

First. Petitioner in effect challenges the power of the Circuit Court of Appeals to pass upon any questions other than those which were directly and squarely presented in the proceedings before the Board of Tax Appeals. That court's authority to review decisions of the Board rests on statutes, which provide in part that the Circuit Courts of Appeals "have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require." 26 U. S. C. § 1141(c)(1) (Supp.1939). In general, it is the function of the Board to determine the facts of a tax controversy on issues raised before it and to apply the law to those facts; and it is the function of the reviewing court to decide whether the Board has applied the correct rule of law.[5]

Ordinarily an appellate court does not give consideration to issues not raised below. For our procedural scheme contemplates that parties shall come to issue in the trial forum vested with authority to determine questions of fact. This is essential in order that parties may have the opportunity to offer all the evidence they believe relevant to the issues which the trial tribunal is alone competent to decide; it is equally essential in order that litigants may not be surprised on appeal by final decision there of issues upon which they have had no opportunity to introduce evidence. And the basic reasons which support this general principle applicable to trial courts make it equally desirable that parties should have an opportunity to offer evidence on the general issues involved in the less formal proceedings before administrative agencies entrusted

[4] Cf., e. g., Helvering *v.* Hormel, 111 F. (2d) 1 (the decision below), with Helvering *v.* Richter, 114 F. (2d) 452, reversed this day.

[5] The Board's rulings on questions of law, while not as conclusive as its findings of fact, are nevertheless persuasive, and it is desirable that a reviewing court have the benefit of such rulings. See Helvering *v.* Wood, 309 U. S. 344, 349; Helvering *v.* Tex-Penn Oil Co., 300 U. S. 481, 498. This is true not only of the Board of Tax Appeals but of other administrative bodies as well. Cf. Federal Trade Commission *v.* R. F. Keppel & Bro., 291 U. S. 304, 314.

with the responsibility of fact finding. Recognition of this general principle has caused this Court to say on a number of occasions that the reviewing court should pass by, without decision, questions which were not urged before the Board of Tax Appeals. But those cases do not announce an inflexible practice, as indeed they could not without doing violence to the statutes which give to Circuit Courts of Appeals reviewing decisions of the Board of Tax Appeals the power to modify, reverse or remand decisions not in accordance with law "as justice may require." There may always be exceptional cases or particular circumstances which will prompt a reviewing or appellate court, where injustice might otherwise result, to consider questions of law which were neither pressed nor passed upon by the court or administrative agency below. See *Blair* v. *Oesterlein Machine Co.*, 275 U. S. 220, 225.

Rules of practice and procedure are devised to promote the ends of justice, not to defeat them. A rigid and undeviating judicially declared practice under which courts of review would invariably and under all circumstances decline to consider all questions which had not previously been specifically urged would be out of harmony with this policy. Orderly rules of procedure do not require sacrifice of the rules of fundamental justice. And examination of the cases relied upon by petitioner discloses that this Court, in following in some cases the general principle sought to be invoked here by petitioner, has been careful to point out the circumstances justifying application of the practice in the particular case. Thus, for example, we held in *Helvering* v. *Wood*, 309 U. S. 344, 348-349, that the government could not present in this Court as a wholly new issue the applicability of section 22(a). But we there especially relied upon the fact that the government, when the case was before the Circuit Court of Appeals, had made an express waiver of any reliance upon 22(a). In *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481, 498, this Court declined to consider a newly presented question, but pointed out that it had not been raised by the Commissioner either in his notice of tax deficiency, in his appearances before the Board of Tax Appeals or the Circuit Court of Appeals, or in his petition for certiorari to this Court. And in *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200, 206-207, though this Court said that the Circuit Court of Appeals should not have considered a contention not presented to or ruled upon by the Board of Tax Appeals, the statement was buttressed by adding that the Circuit Court of Appeals

had "made an inference of fact directly in conflict with the stipulation of the parties and the findings, for which we think the record affords no support whatever. To remand the cause for further findings would be futile. The Board could not properly find anything which would assist the Commissioner's cause." The plain implication of that decision was that the cause would have been remanded to the Board of Tax Appeals had the Court considered the newly raised point to be of sufficient merit. These decisions and others like them, while recognizing the desirability and existence of a general practice under which appellate courts confine themselves to the issues raised below, nevertheless do not lose sight of the fact that such appellate practice should not be applied where the obvious result would be a plain miscarriage of justice. Analogous in principle is the philosophy which underlies this Court's decisions with relation to appellate practices in other cases: those in which it has been held that a decision of the Board of Tax Appeals can be supported in the reviewing court on a new theory of law;[6] those which have been remanded because the lower courts failed to give consideration to a phase of the case involving legal theories not presented;[7] and those in which there have been judicial interpretations of existing law after decision below and pending appeal—interpretations which if applied might have materially altered the result.[8] Whether articulated or not, the philosophy underlying the exceptions to the general practice is in accord with the statutory authority given to courts reviewing decisions of the Board of Tax Appeals—decisions not in accordance with law should be modified, reversed or reversed and remanded "as justice may require."

In accordance with this principle, we are of opinion that the court below should have given and properly did give consideration to section 22(a) in determining petitioner's tax liability. The Commissioner urged this point before the Circuit Court of Appeals and has strongly presented it here. At the time the Board of Tax Appeals made its decision in this case, we had not yet handed down our opinion in *Helvering* v. *Clifford,* 309 U. S. 331, in which we held that under section 22(a) the income of certain trusts was taxable to respondent. The Circuit Court of Appeals was of

[6] E. g., Helvering *v.* Gowran, 302 U. S. 238, 246.

[7] E. g., United States *v.* Shelby Iron Co., 273 U. S. 571, 579; United States *v.* Rio Grande Dam & Irrigation Co., 184 U. S. 416, 423.

[8] E. g., Vandenbark *v.* Owens-Illinois Glass Co., No. 141 this Term, and cases there cited.

opinion that there were no controlling distinctions between the trusts created by petitioner in this case and those created by Clifford. Here, as there, control over the trusts was completely in the hands of the taxpayer and his wife. For while petitioner's trust instruments showed a co-trustee acting with petitioner, the same instruments also disclosed that such co-trustee could be removed at any time by the joint action of petitioner and his wife. "To hold otherwise [i. e., that petitioner is not subject to the tax] would be to treat the wife as a complete stranger; to let mere formalism obscure the normal consequences of family solidarity; and to force concepts of ownership to be fashioned out of legal niceties which may have little or no significance in such household arrangements."[9] As the record now stands we think the court below correctly concluded that the trust income was taxable to petitioner under the principles announced in the *Clifford* case. Therefore to apply here the general principle of appellate practice for which petitioner contends would result in permitting him wholly to escape payment of a tax which under the record before us he clearly owes. Thus viewed, this is exactly the type of case where application of the general practice would defeat rather than promote the ends of justice, and the court below was right in so holding.

But the Board of Tax Appeals neither found the facts nor considered the applicability of 22(a) in the light of the *Clifford* case. Congress has entrusted the Board with exclusive authority to determine disputed facts. Under these circumstances we do not feel that petitioner should be foreclosed from all opportunity to offer evidence before the Board on this issue, however remote may be his chance to take his case out of the *Clifford* rule.[10] Accordingly, the judgment of the lower court reversing the decision of the Board of Tax Appeals is affirmed, with directions to the Board of Tax Appeals for further proceedings in accordance with this opinion.

It is so ordered.

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[9] Helvering *v.* Clifford, 309 U. S. 331, 336-337.

[10] In this connection petitioner pointed out in his brief before the Circuit Court of Appeals that "If any contention whatsoever had at any time been suggested or considered as to Section 22, the matter of the evidence introduced or to be introduced would have required further consideration."